

IASBriefing

This special issue of *IASBriefing* summarises the key points of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Overview

On 31 March 2004, the International Accounting Standards Board (IASB) published IFRS 5. This is the first new standard issued as part of the IASB's short-term convergence project with the US Financial Accounting Standards Board (FASB). It is intended to increase convergence with US GAAP. It specifies the accounting for assets (and disposal groups) that are held for sale and the presentation and disclosure of discontinued operations. This includes ceasing depreciation of assets held for sale.

IFRS 5 should be applied for annual reporting periods beginning on or after **1 January 2005**. It includes transitional provisions that permit prospective application by current IFRS reporters and by those applying IFRS 1 *First-time Adoption of IFRSs* with a date of transition that is *before* 1 January 2005.

IFRS 5 replaces IAS 35 *Discontinuing Operations*.

Scope

The *classification* and *presentation* requirements of the standard apply to all non-current assets and disposal groups.

The *measurement* requirements apply to all 'disposal groups' and to all recognised non-current assets except for financial assets, deferred tax assets, assets related to employee benefits and insurance contracts, and certain assets whose subsequent measurement is based upon fair value (e.g., investment properties measured at fair value in accordance with IAS 40 *Investment Property*). The *measurement* of these excluded assets continues to be dealt with under the standards that normally apply to these items, even if such an asset is part of a disposal group. However, the disposal group as a whole must be measured in accordance with IFRS 5.

Non-current assets (and disposal groups) held for sale

Definitions

IFRS 5 introduces the notion of a 'disposal group', being a group of assets to be disposed of together, by sale or otherwise, in a single

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transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

A *new* classification of assets as ‘assets held for sale’ also has been introduced. A non-current asset (or disposal group) is held for sale if its carrying amount will be recovered ‘principally through sale’. This principle is supplemented by a series of criteria that must be met for this to be the case. These criteria are based on those of the equivalent US standard, SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. Examples of the application of these criteria are provided in the Implementation Guidance attached to IFRS 5.

A non-current asset (or a disposal group) acquired exclusively with a view to its subsequent disposal is classified as held for sale if it meets the ‘held for sale’ criteria or if it is *highly probable* that it will meet those criteria within a short period (usually three months).

Measurement

Summarised below are the key measurement requirements with respect to non-current assets (or disposal groups) classified as assets held for sale.

- A non-current asset (or disposal group) should be remeasured in accordance with applicable IFRSs (e.g., revalued, tested for impairment etc.) immediately before it is classified as held for sale. Any resulting gains or losses are recognised in accordance with the relevant standards.
- On *initial classification* as held for sale, disposal groups and non-current assets are measured at the lower of (i) carrying amount, and (ii) fair value less costs to sell.
- Subsequently, disposal groups and non-current assets are remeasured at fair value less costs to sell. However, remeasurement upwards is subject to the gain recognition limit described below.
- On each subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of IFRS 5 are measured in accordance with other applicable IFRSs before the disposal group is remeasured to fair value less costs to sell. It appears that any gains and losses on this remeasurement are recognised in accordance with the relevant standards.
- Impairment losses on *initial classification* as held for sale, and gains and losses on subsequent remeasurement to fair value less costs to sell, are included in profit or loss regardless of whether the asset is (or the disposal group includes assets that are) previously measured based on revalued amounts.
- The maximum increase (and therefore gain) that can be recognised as a result of an increase in fair value less costs to sell is the cumulative amount of impairment losses recognised either in accordance with IFRS 5 or previously in accordance with IAS 36 *Impairment of Assets*.
- Gains and losses resulting from measurement of a disposal group are allocated to the non-current assets in that group that are within the scope of the *measurement* requirements of IFRS 5 in the order of allocation required by IAS 36 (i.e., in the case of losses, first to goodwill and then to other assets on a pro-rata basis).
- Non-current assets classified as held for sale, or included in a disposal group, are *not* depreciated.

Reclassification as *not* held for sale

- If the criteria for classification as ‘held for sale’ are no longer met, the related non-current assets are measured at the lower of (i) their carrying amounts had the assets not been classified as held for sale, and (ii) their recoverable amount.

Acquired with a view to disposal

- A non-current asset (or a disposal group) acquired exclusively with a view to its subsequent disposal is measured on initial recognition at the lower of its (i) carrying amount had the asset (or disposal group) not been classified by the purchaser as held for sale (e.g., cost or fair value), and (ii) fair value less costs to sell.

Presentation and disclosure requirements

The key presentation and disclosure requirements relating to non-current assets (or disposal groups) are:

- separate presentation, on the face of the balance sheet, of the total of each of:
 - non-current assets classified as held for sale (whether separately or as part of a disposal group); and
 - liabilities classified as held for sale as part of a disposal group;
- analysis of the above into major classes of assets and liabilities, either on the face of the balance sheet or in the notes to the financial statements, except where the disposal group is a newly acquired *subsidiary* that is classified as held for sale on its acquisition;
- separate presentation of any amounts recognised directly in equity that relate to non-current assets (or a disposal group) classified as held for sale (e.g., revaluation reserves, cumulative translation differences);
- descriptions of the non-current assets (or disposal groups) classified as held for sale and the reasons for reclassification. If applicable, the notes should disclose the segment in which the non-current asset (or disposal group) classified as held for sale is included; and
- the gain or loss arising on reclassification or subsequent measurement of a non-current asset (or disposal group) classified as held for sale.

The above disclosures are required for all non-current assets (or disposal groups) classified as held for sale at a given balance sheet

date. However, classification in prior periods is not revised where a non-current asset (or disposal group) initially is classified as held for sale in the current period.

As noted above, the analysis of assets and liabilities into major classes is not required if the disposal group is a newly acquired *subsidiary* that is classified as held for sale on its acquisition. As discussed below, a consequential amendment was made to IAS 27 *Consolidated and Separate Financial Statements* that removes the exemption from consolidation of subsidiaries acquired and held exclusively with a view to resale.

The disclosure exemption was provided by the IASB to reduce the burden of measuring the fair value of the assets and liabilities for these subsidiaries. However, when a disposal group includes liabilities or assets that are outside the scope of the measurement requirements of IFRS 5 and are subject to the measurement requirements of other IFRSs (e.g., financial assets that are measured at fair value through equity), it may be necessary to determine the acquisition date fair value of those individual assets and liabilities of the disposal group.

Discontinued operations

As mentioned, IFRS 5 replaces IAS 35. The impacts of this change are noted below.

- IFRS 5 changes the timing of classification of a discontinued operation to the earlier of the date that:
 - the entity actually has disposed of the operation; and
 - the operation meets the criteria to be classified as held for sale.

This contrasts with the existing requirements of IAS 35 that classify an operation as discontinuing at the earlier of (i) the entity entering into a binding sale agreement, and (ii) the directors approving and announcing a formal disposal plan.

- The standard limits discontinued operations presentation to a *component* of an entity that:
 - represents a separate major line of business or geographical area of operations (or is part of a co-ordinated single plan to dispose of such a component); or
 - is a subsidiary acquired exclusively with a view to resale.

These criteria are the same as those currently in IAS 35.

- A component of an entity is defined as operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
- The retroactive classification as a discontinued operation is now *prohibited* when the criteria are met *after* the balance sheet date. Instead, disclosures are required in the notes to the financial statements.

Presentation and disclosure requirements

The key presentation and disclosure requirements relating to discontinued operations are:

- separate presentation on the face of the income statement of a single amount relating to discontinued operations;
- an analysis of the single amount either on the face of the income statement or in the notes to the financial statements, showing separately: revenue, expenses, pre-tax profit or loss, income tax expense and gains and losses on measurement to fair value less costs to sell (and, separately, income tax expense thereon); and
- the net cash flows attributable to the operating, investing and financing activities of discontinued operations, either on the face of the statement of cash flows or in the notes to the financial statements.

The above analysis and cash flow information is not required for a disposal group that is a newly acquired *subsidiary* that is classified as held for sale on its acquisition.

Comparative income statement (and cash flow) information is required and must be restated each year so that comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current balance sheet date.

Consequential and related amendments to other IFRSs

IFRS 5 makes a number of consequential and related amendments to other IFRSs, including some of those that were amended recently as part of the Improvements issued in December 2003. (An overview of the Improvements is provided in IAS *Briefing*, Issue 15, January 2004.)

Most notably, IFRS 5 removes the exemption from consolidation in IAS 27 for subsidiaries acquired and held exclusively with a view to resale. As a result, such subsidiaries must be consolidated but are classified, measured and presented as held for sale if they meet the relevant criteria. When the subsidiary meets these criteria, certain disclosure exemptions in respect of both disposal groups and discontinued operations are provided to reduce the burden of this change. The intention is to reduce the need for a fair value exercise of individual assets and liabilities in respect of such a subsidiary.

IFRS 5 also clarifies the application of IAS 1 *Presentation of Financial Statements* (paragraph 57(c)) by noting that a non-current asset should not be reclassified as current when it is expected to be realised within 12 months of the balance sheet date unless the asset meets the criteria to be classified as held for sale.

Transitional provisions

The standard is effective for annual reporting periods that begin on or after 1 January 2005. It includes transitional provisions that permit prospective application by current IFRS reporters and by those applying IFRS 1 with a date of transition that is before 1 January 2005.

However, the standard must be applied retrospectively by entities preparing financial statements in accordance with IFRS 1 with a date of transition that is on or after 1 January 2005.

All entities are permitted to choose to apply the standard to all non-current assets (or disposal groups) held for sale and operations discontinued after a date earlier than 1 January 2005, provided that the valuations and other information needed to apply the standard were obtained at the time that the original events were accounted for.

Convergence with US GAAP

An objective of IFRS 5 is to increase convergence in this area with US GAAP (notably SFAS 144). However, convergence is not achieved in two significant areas:

- in respect of the impairment of long-lived assets that will be held and used. Significant differences exist and convergence was not proposed in the exposure draft; and
- the definition of a discontinued operation. ED 4 had proposed convergence with SFAS 144 in this area, but emerging interpretive issues in the US led the IASB to revert to the definition in IAS 35. The IASB has noted an intention to arrive at a converged definition; therefore, further changes in this area are likely.

Significant changes from the exposure draft

The key changes from the proposals in ED 4 *Disposals of Non-current Assets and Presentation of Discontinued Operations* are described below.

- **Definition of a discontinued operation** – IFRS 5 reverted back to the IAS 35 definition of an operation. ED 4 had proposed setting the classification threshold for a discontinued operation as any unit whose operations and cash flows can be clearly distinguished operationally and for financial reporting purposes. This would have required many more asset groups to be presented as discontinued operations.
- **Presentation of gains and losses on revalued assets** – IFRS 5 simplified the ED proposals in this area. ED 4 had proposed that for revalued assets, impairment losses arising from the write-down of assets (or disposal groups) to fair value less costs to sell (and subsequent gains) should be treated as revaluation decreases in accordance with the standard under which the assets were revalued, except to the extent that the losses arose from the recognition of costs to sell. The final standard requires the recognition of all losses (and any remeasurement gains) in profit or loss for assets within its measurement scope.

If you would like further information on any of the matters discussed in this *IASBriefing*, please talk to your usual local KPMG contact or call any of our member firm offices.

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